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No. 98-1966

In the Supreme Court of the United States

SHERMAN PARK APARTMENTS, ET AL.,
PETITIONERS,
v.
UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

Although the United States seeks for purposes of certiorari to characterize the petition as raising a mere "fact-bound controversy," Opp. 11, it does not seriously dispute the enormous impact of the Federal Circuit's decision. The government does not deny that the documents at issue in this case are typical of those in hundreds of identified transactions nationwide, which guaranteed the developers who provided this country's low-income housing the unfettered right to exit the program after 20 years. The government also does not dispute that, if not reversed, the Federal Circuit's decision will deny recovery to hundreds of plaintiffs who, like the plaintiffs in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), agreed to assist in the government's efforts to rescue the failing savings and loan industry.

The decision below will have these and other far-reaching effects because, contrary to the government's current litigating position before this Court, this case raises fundamental questions regarding the approach that courts should take in construing complex government contracts; questions that, depending on the answer, could permit the government to shift the costs of several multi-billion dollar public programs to private parties who contracted with the United States under the mistaken impression that the government would keep its word.

The government contests none of this. Indeed, the government does not even dispute that it promised petitioners that they could prepay their mortgage loans after 20 years without HUD approval. Rather, the government seeks to evade *contractual* liability on the ground that its structured the transaction in a way that relieves it of the responsibility of keeping its promise. The government's analysis suffers from the same fatal

flaw as that of the Federal Circuit majority: Like the majority, the government views each of the relevant documents of the transaction as they "stand[] alone," instead of viewing them as part of an integrated whole. Pet. App. 22a.

1. The government concedes, as it must, that these housing transactions involved an agreement between plaintiffs and HUD and that one of the documents integral to each transaction — the deed of trust note — expressly provided that "the loan could not be prepaid without HUD approval for the first 20 years, but could be prepaid without approval after that time." Opp. 3.[1] The government does not dispute, moreover, that this prepayment provision allocated rights between the government and petitioners. *See* Pet. App. 57a-58a. The government argues, however, that it is not contractually responsible for the prepayment promise made to petitioners because it was not formally named as a party to the note. Absent HUD's signature, the government insists that the note must be viewed as a "separate agreement[]" solely between petitioners and their private lenders. Opp. 7-8.

The government's argument merely repeats the fundamental error committed by the Federal Circuit majority: it views each of the transactional documents as relevant only in "determining the meaning *of each separate contract*," *id.* (quoting Pet. App. 21a-22a) (emphasis added), and refuses to interpret the documents together, as an integrated whole, to

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[1] The government's string cite showing an absence of privity in other cases brought under the National Housing Act is inapposite. Opp. 10 n.11. In those cases, the developer had not entered into any transaction with HUD. In this case, it is undisputed that petitioners and HUD are in privity of contract. The only issue here is the terms of the contract.

determine the intent of the parties.[2] As the Court of Federal Claims correctly observed, the parties' intent in a complex transaction of this sort can be determined only "by examining all of the documents involved in the transaction and focusing on the substance of the prepayment terms rather than only their location." Pet. App. 120a n.10.[3]

The government has never before offered any reason why the petitioners and their private lenders — the only parties, according to the government, who are contractually bound by the prepayment provision in the note — would have bothered to negotiate that provision between themselves, as it allocates rights and obligations predominantly between the government and petitioners. Now, for the first time, the government suggests that the prepayment provision was inserted in the note because it was "necessary" to conform the note to HUD's regulations governing prepayment. Opp. 9-10. This suggestion makes no sense. HUD's regulations would have prevented prepayment during the first 20 years, regardless of the language of the note's prepayment provision. Moreover, if the lender and petitioners had intended

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[2] Restatement (Second) of Contracts § 202(2) ("all writings that are part of the same transaction are interpreted together"). *See also, e.g., Joy v. City of St. Louis*, 138 U.S. 1, 38 (1891); *Dakota Gasification Co. v. Natural Gas Pipeline Co. of America*, 964 F.2d 732, 735 (8th Cir. 1992).

[3] Contrary to the government's argument, Opp. 8, recognizing, based on the substance of the text, that the note contains an agreement between the government and petitioners regarding prepayment is not equivalent to saying that all of the "rights and obligations" in each of the documents are "common to all the participants." As the Court of Federal Claims observed, the text of Rider A to the note "gave the lender no right whatsoever to interfere with an owner's plan to prepay. The rider gave that power only to HUD." Pet. App. 57a. In contrast, provisions in the documents that allocate rights and obligations solely between the developer and the lender would not contractually bind HUD.

merely to acknowledge that the note would be governed by HUD's regulations, they could have inserted specific language to that effect, rather than language that contractually guaranteed petitioners particular prepayment rights. *See, e.g.*, Fed. Cir. J.A. 139 (provision of regulatory agreement requiring petitioners to comply with federal anti-discrimination statutes). Contrary to the government's *post hoc* rationale, by its plain terms, the prepayment provision in the note was inserted to signify the *government's* contractual obligation to petitioners to allow unfettered prepayment after 20 years.[4]

The government acknowledges that it received a benefit from the prepayment provision in the deed of trust note, but insists that, as a third-party beneficiary, it cannot have undertaken any corresponding obligations. Opp. 10 n.10. This argument is half right. The government surely did receive a benefit from the prepayment provision, which required the developers to maintain their properties as low-income housing for 20 years. But the provision provided the developers a benefit as well — the right to prepay their mortgage loans after 20 years and exit the low-income housing programs. Contrary to the government's suggestion, HUD was a party, not merely a third party, to the prepayment agreement, and as such, the benefits it derived and obligations it undertook were flip sides of the same coin.

Despite the government's protests, the simple truth is that it was no "stranger to the agreement." Opp. 10 n.10 (brackets omitted) (quoting Pet. 19). As

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[4] As *amici* observe, the government's prepayment promise probably was placed as a rider to the deed of trust note because that was the most logical location for it to be placed. Brief of *Amici Curiae* Institute for Responsible Housing Preservation *et al.* (*Amici* Br.) at 16-17.

thoroughly documented by *amici*, HUD exercised complete control over the preparation of all of the documents, including the deed of trust note and the regulatory agreement.[5] The government should not now — after it has received the entire benefit of its bargain — be permitted to escape its contractual responsibilities by suggesting cynically that petitioners and their lenders included the prepayment provision as an agreement solely between themselves.

To the extent the documents leave any doubt about the parties' intent, it is resolved by HUD's unequivocal admissions that it made a contractual commitment to the developers that it would permit them to prepay their mortgage loans and exit the low-income housing programs.[6] The government attempts to sidestep those admissions in a footnote, asserting that they are "little help in answering [the] question" of whether HUD "made a contractual promise" on the issue of prepayment rights. Opp. 9 n.9. The parties' views on the meaning of a contract are entitled to great weight, however, even if those views are expressed after the contract has been signed.[7]

Indeed, Members of Congress fully understood when they enacted the Emergency Low-Income Housing Preservation Act of 1987 (ELIHPA), Pub. L.

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[5] *See, e.g., Amici* Br. at 10-12.

[6] *See* Pet. 7-8 (Secretary Kemp objecting to an abrogation of "the contract that we entered into"); *id.* (R. Hunter Cushing, the Deputy Assistant for HUD's Multifamily Housing Programs, testifying that "there was a contractual relationship between the Federal Government and private owners that was negotiated at that time [and] that cannot be changed").

[7] *See, e.g., Chicago v. Sheldon*, 76 U.S. 50, 54 (1870) (holding that "the practical interpretation by the parties themselves is entitled to great, if not controlling, influence"); *see also* Restatement (Second) of Contracts § 201(1) (1981) ("Where the parties have attached the same meaning to a promise or agreement or a term thereof, it is interpreted in accordance with that meaning").

No. 100-242, tit. II, 101 Stat. 1877 (1988), and the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA), Pub. L. No. 101-625, tit. VI, 104 Stat. 4249, that the statutory abrogation of the developers' prepayment rights violated the government's *contractual* commitments. *See* Pet. 2, 6-11. The government's contention that the Members' statements merely "reflect" what developers "likely expected" based on HUD's prepayment regulations (Opp. 8 n.9) ignores the explicit acknowledgement by both supporters and opponents of ELIHPA and LIHPRHA that the enactment of those statutes would breach a contractual promise between the government and developers. Pet. 2, 6-11. While these admissions may be inconvenient to the government's current litigating position, they reflect what the parties understood for 20 years to be the nature of their deal, and they should not be ignored.

2. The government's attempt to distinguish this case from *United States v. Winstar Corp.*, 518 U.S. 839 (1996), is wholly unpersuasive. In *Winstar*, the government's position, like its position in this case, was that its promise of favorable regulatory treatment "simply reflect[ed] statements of then-current federal regulatory policy rather than contractual undertakings." *Id.* at 862 (plurality opinion). Indeed, that essentially remains the government's position with respect to all *Winstar*-type plaintiffs that do not have the government's promise of favorable regulatory treatment "expressly incorporated" (Opp. 12 (quoting Pet. App. 28a)) into a document to which the government was formally party. *See California Fed. Bank v. United States*, 39 Fed. Cl. 753, 772-74 (1997). *Winstar*, however, was not so limited.

To begin with, the promise of favorable regulatory treatment in *Winstar* was not "expressly incorporated"

into the plaintiffs' contracts with the government. Opp. 12 (quoting Pet. App. 28a). Rather, the relevant provision merely stated that certain contemporaneous documents — including those containing the government's promise — were not excluded by the Supervisory Agreement's integration clause.[8] The exceptions from the integration clause were considered part of the contract as a matter of negative implication. *Id.*; *see also id.* at 846 (plurality opinion). Here, other considerations — including the interrelationship between the petitioners' obligations under the regulatory agreement and their prepayment rights under the deed of trust note — similarly make clear that the government's promise to permit unfettered prepayment after 20 years was not merely "then-current federal policy" but rather part of the government's "contractual undertaking[]." *See id.* at 862 (plurality opinion).

The government is also mistaken in disputing that this Court would have reached the same result in *Winstar* absent the integration clause by examining the underlying "realities' of the transaction." Opp. 12 n.12. In *Winstar*, the plurality stated that "[t]o the extent that the integration clause leaves any ambiguity, . . . the realities of the transaction favored reading those documents as contractual commitments." 518 U.S. at 863. Contrary to the government's argument (Opp. 12 n.12), nothing in this statement implies that the plurality considered the "realities of the transaction" because the integration clause was ambiguous. Rather, the plurality independently examined the "realities of

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[8] 518 U.S. at 862 (plurality opinion) (integration clause stated that "[t]his Agreement . . . constitutes the entire agreement between the parties thereto and supercedes all prior agreements . . . excepting only the Agreement of Merger and any resolutions or letters issued contemporaneously herewith").

the transaction" to confirm the conclusion it reached by examining the integration clause.[9] *Winstar* provides no support for the government's attempt to limit consideration of the realities of the transaction in this case.

3. The government concedes that the "commitment issued by HUD to petitioners and their lenders 'incorporated the regulations *then in effect* into HUD's offer to the developers.'" Opp. 13 (internal brackets omitted) (quoting Pet. 25-26). It argues, however, that the regulations that were incorporated did not include the regulation granting petitioners the right to prepay their mortgages without HUD approval after 20 years. *Id.* The government is fundamentally mistaken.

The commitment expressly provided that HUD would extend mortgage insurance under Section 221(d)(3) or 236 of the National Housing Act (NHA) and the "Regulations *thereunder* now in effect." Pet. App. 37a (emphasis added) (emphasis in original omitted). *See also* Fed. Cir. J.A. 122, 142. This language, by its terms, includes all of the regulations promulgated under the applicable section. The regulations promulgated under Section 221(d)(3) include all of 24 C.F.R. Part 221, Subpart C and D (1970), including the prepayment regulation. 24 C.F.R. § 221.524 (1970). The regulations promulgated under Section 236 include all of 24 C.F.R. Part 236, including the prepayment regulation. 24 C.F.R. § 236.30 (1970). Thus, the express

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[9] The plurality's immediate citation to the Restatement (Second) of Contracts § 202(1) eliminates any doubt. 518 U.S. at 863. Comment a of that section explicitly provides that the "rules in this Section [202] are applicable to all manifestations of intention and to all transactions" and that "[t]hey do not depend upon any determination that there is an ambiguity." And comment c makes clear that "[e]ven language which is otherwise explicit may be read with a modification needed to make it consistent with" the principal purpose of the parties.

terms of the commitment incorporated the applicable prepayment regulation for each program.

The government mischaracterizes the regulations when it argues that the insurance contract did not include the prepayment regulations. Opp. 13-14. HUD's regulations provided that the "contract of insurance" "includes the terms, conditions and provisions of this *part*." 24 C.F.R. § 207.251 (1970) (emphasis added). That definition was incorporated by reference into Parts 221 and 236. 24 C.F.R. §§ 221.751, 236.251. Thus, the provisions of Parts 221 and 236, including the prepayment regulations, comprised the contract of insurance, and the provisions of Parts 221 and 236, including the prepayment regulations, were incorporated by reference into the commitment.

The government also relies heavily on a regulatory provision reserving HUD's right to amend the regulations. Opp. 8 n.8, 14; 24 C.F.R. §§ 221.749, 236.249 (1970). The government, however, knows full well that it cannot reserve the unfettered right to alter or repudiate its contractual obligations without paying the consequences for the breach. It has long been settled that the right to amend "is not unlimited and cannot be exerted to defeat the purpose [of the contract] . . . or arbitrarily to make alterations that are inconsistent with the scope and object of the [contract] or to destroy or impair any vested property right."[10] Any alternative rule would render the government's promises illusory, since later actions by Congress could, at any time, undo the underlying *quid pro quo* that

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[10] *See, e.g., Phillips Petroleum Co. v. Jenkins*, 297 U.S. 629, 634-35 (1936); *Sinking Fund Cases*, 99 U.S. 700, 720-21 (1878); Restatement (Second) of Contracts § 2 cmt. e (stating that illusory promise is formed "[e]ven if a present intention is manifested, [where] the reservation of an option to change that intention means that there can be no promisee who is justified in an expectation of performance").

formed the basis for a contract. *See Winstar*, 518 U.S. at 921 (Scalia, J., concurring). The government's reservation of a right to amend its regulations cannot be stretched so far as to excuse the government's unilateral cancellation of petitioners' contractual rights.

CONCLUSION

More than 100 years ago, Justice Bradley observed that legislation by Congress abrogating the terms of this nation's contractual commitments

> is well calculated to excite alarm. It has the effect of announcing to the world, and giving it to be understood, that this Government does not consider itself bound by its engagements. It sets the example of repudiation of government obligations. It strikes a blow at the public credit. It asserts the principle that might makes right. It saps the foundation of public morality.

Sinking Fund Cases, 99 U.S. at 750 (Bradley, J., dissenting). Though illegitimate, this power is politically attractive. Here, Representative Kennedy argued that Congress should not let "some fine print allowing prepayment" interfere with the government's responsibility to house low-income tenants.[11] Repudiating that fine print was the sovereign's prerogative. It is the courts' duty, however, to hold the government liable for the breach. Failure to do so will encourage Congress, for short term advantage, to ignore the nation's contractual commitments.

The petition for a writ of certiorari should be granted.

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[11] *Preservation and the Loss of Subsidized Housing Stock: Hearing Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 2d Sess. 6 (1990).

Respectfully submitted,

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